Long Term Global Growth

Reflections

May 2023

Kaizen – continuous improvement

The Japanese term *kaizen*, meaning continuous improvement, was popularised by Toyota's founder, Sakichi Toyoda, in the 1970s. He believed continuous changes to enhance efficiency were crucial to a business's long-term success. *Kaizen* can be directed at everything within a business, whether processes, products, or people, and is synonymous with constantly striving for better efficiency and quality of work.

While *kaizen* is expected in every company within the portfolio, Toyota's influence is directly reflected in a new holding in electric vertical take-off and landing (eVTOL) company Joby Aviation. Toyota holds approximately a 12 per cent stake following an investment of around $400m in 2020, and provides critical powertrain and actuation components to produce Joby's aircraft. Moreover, the company advises on the design of Joby's pilot production line (which tests new methods, processes and systems) in Marina, California. Its engineering and manufacturing expertise is helping to accelerate Joby towards certification by the Federal Aviation Administration (FAA).

The LTGG team strives for *kaizen*. The portfolio has delivered significant underperformance in the past couple of years, after a long period of generally strong performance culminating in an off-the-charts year in 2020. Although uncomfortable, periods of underperformance are unavoidable when employing a high-conviction investment strategy with long holding periods. Traits like these are essential for achieving long-term outperformance, but they can still make us look foolish in the short term.

Since the beginning of the LTGG strategy nearly two decades ago, we have outperformed around 70 per cent of rolling one-year periods. This performance is a reasonable hit rate, but it still means our clients have experienced periods of underperformance every three to four years. However, when looking at rolling five-year periods, the picture drastically improves, with outperformance in 98 per cent of periods as the strength of fundamentals comes to the fore. Despite this volatility, returns have been approximately 3+ per cent per annum, net of fees above the benchmark since 2004.

Courtesy of Joby Aviation. © Joby Aero, Inc.

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Nevertheless, we are not immune to criticism in the current environment. Periods of underperformance are unusually information-rich, as they force us to scrutinise the process underlying our long-term investment philosophy, and there are always opportunities to improve. Our strong relationship with our Investment Risk Team, led by Tim Alcorn, has provided us with helpful insights for many years. They recently reviewed our trading patterns over the long term, providing helpful feedback that can support awareness and continuous improvement in our process.

One area highlighted was the value destruction from making additions during share price weakness. Although not detrimental to performance since inception, this issue has been felt more acutely in recent years and represents an opportunity for improvement. We made unforced errors by adding to positions during share price weakness when the underlying investment case had not been sufficiently de-risked to justify such conviction on our part. For example, we consider Peloton, Zoom, and Carvana to be examples of this, which are no longer in the portfolio.

We have introduced a slight process improvement by adding a research and development (R&D) 'bucket', or group of holdings, to prevent this from happening again. This bucket includes companies identified as having the highest company-level risk. The blue-sky investment case remains highly compelling, but the possible outcomes for these businesses are still wide. LTGG must continue to embrace uncertainty, as probability-adjusted payoffs can be significant. However, a guardrail has been added, meaning the team can only make additions once the investment case has been de-risked against signposts identified when we take the initial holding.

Joby Aviation, mentioned earlier, is one company that begins as an R&D holding. The company comprises a small part of the portfolio at approximately 0.7 per cent; it remains pre-revenue and awaits separate certifications from the military and the FAA before its aircraft can be used widely. These certifications are agreed milestones towards de-risking, which could then prompt an addition. Until then, we will not add to the holding. The other names in the R&D bucket are Samsara, Datadog, SEA, Roblox, Affirm, and Ginkgo Bioworks.

Our commitment to *kaizen* remains steadfast within the decision-making team, and we will continue to assess and ensure that this philosophy is being upheld throughout portfolio holdings.

Important information and risk factors

Annual past performance to 31 March each year (net %)

	2019	2020	2021	2022	2023
LTGG Composite	8.4	10.7	104.4	-18.1	-18.1
MSCI ACWI Index	3.2	-10.8	55.3	7.7	-7.0

Annualised returns to 31 March 2023 (net %)

	1 Year	5 Years	10 Years	Since Inception*
LTGG Composite	-18.1	10.5	15.2	11.4
MSCI ACWI Index	-7.0	7.5	8.6	7.6

*Inception date 29 February 2004.
Source: Baillie Gifford & Co and MSCI. US Dollars.
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Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 / bailliegifford.com

CO1594903 LTGG Monthly_May 0623
Ref: 46928 10021283